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TAGS: EFIN, ECON, CA

SUBJ: STAGFLATION IN CANADA

1. SUMMARY: ON NOV 29 STATISTICS CANADA (STATCAN) REPORTED CANADA'S REAL GNP GROWTH IN THIRD QUARTER OF 1974 REMAINED UNCHANGED FOR SECOND CONSECUTIVE QUARTER. THIRD QUARTER GNP AT CURRENT PRICES WAS HIGHER DUE ENTIRELY TO PRICE RISES; HOUSING SLUMP BECAME MORE PRONOUNCED, AND TRADEDEFICIT WIDENED. GOC OFFICIALS CONTINUE MAINTAIN ECONOMY IS BASICALLY SOUND AND RECESSION IN CANADA'S CHIEF TRADING PARTNERS IS MAIN REASON FOR LACK OF GROWTH. EMBASSY LARGELY AGREES WITH THIS VIEW BUT NOTES OTHER DISTURBING FACTORS WHICH COULD PUSH ECONOMY FROM NO GROWTH SITUATION INTO MILD RECESSION. SAVING FACTOR WOULD BE UPTURN IN U.S. ECONOMY WHICH WOULD FAVORABLY IMPACT ON CANADA. END SUMMARY.

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2. CANADA'S GNP, SEASONALLY ADJUSTED AT ANNUAL RATES, INCREASED BY 3.8 PERCENT IN THE THIRD QUARTER OF 1974

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TO C\$142,672 MILLION, ACCORDING TO STATCAN, BUT REAL

GNP, EXPRESSED IN CONSTANT (1961) DOLLARS REMAINED VIRTUALLY UNCHANGED AT C\$79,292 MILLION (C\$79,312 MILLION IN SECOND QUARTER). EXPORT/IMPORT COMPONENT (GOODS AND SERVICES) WAS MAJOR WEAKNESS WITH EXPORTS RISING 5.9 PERCENT TO C\$39,544 MILLION AT ANNUAL RATE BUT IMPORTS INCREASING 9.3 PERCENT TO C\$42,316 MILLION, THUS RAISING DEFICIT TO C\$2,772 MILLION COMPARED TO DEFICIT OF C\$1,396 MILLION IN THE SECOND QUARTER.

3. STATCAN REPORTED WAGES, SALARIES AND SUPPLEMENTARY LABOR COMPONENT OF THIRD QUARTER GNP RECORDED LARGEST QUARTERLY PERCENTAGE RISE SINCE EARLY 1951. MOST OF INCREASE, WHICH WAS 5.1 PERCENT OVER SECOND QUARTER, WAS ATTRIBUTED TO PAYMENT OF LUMP SUM COST-OF-LIVING INCREASES IN PUBLIC SECTOR AND HIGHER AVERAGE EARNINGS THROUGHOUT ECONOMY.

4. HOUSING COMPONENT WAS PARTICULARLY WEAK FACTOR IN BUSINESS GROSS FIXED CAPITAL FORMATION. ALTHOUGH TOTAL CAPITAL FORMATION ROSE 4.5 PERCENT IN THIRD QUARTER, HOUSING CONSTRUCTION DROPPED BY 4.9 PERCENT AND HOUSING STARTS DECLINED BY 22.9 PERCENT. MAIN STRENGTH IN CAPITAL FORMATION WAS IN MACHINERY AND EQUIPMENT, WHICH ROSE 7.2 PERCENT.

5. CORPORATION PROFITS WERE UP 3.5 PERCENT TO ANNUAL RATE OF C\$19,424 MILLION AS COMPARED WITH INCREASE OF 7.1 PERCENT IN SECOND QUARTER. FOR FIRST NINE MONTHS OF 1974, PROFITS BEFORE TAXES WERE 35 PERCENT HIGHER THAN IN COMPARABLE PERIOD IN 1973.

6. NEWSPAPERS HEADLINED STATCAN ANNOUNCEMENT, WITH NOVEMBER 30 MONTREAL GAZETTE DECLARING "STAGNANT GNP BRINGS UP TO BORDER OF RECESSION." GLOBE AND MAIL HEADLINE OF SAME DAY WAS "NATION BORDERS ON A RECESSION ECONOMISTS SAY", AND PREVIOUS DAY OTTAWA CITIZEN PROCLAIMED "RECESSION. STATISTICS CANADA REPORT MAY CONFIRM THE WORST OF FEARS." DECEMBER 2 FINANCIAL TIMES BEGAN ITS ARTICLE ON STATCAN FIGURES WITH: "RECESSION IS UPON US, EVEN IF SO FAR IT HAS LIMITED OFFICIAL USE

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BEEN Milder IN CANADA THAN IN OTHER COUNTRIES."

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7. COMMENT: FINMIN TURNER AND OTHER GOC LEADERS CONTINUE TO EXPRESS PUBLIC CONFIDENCE IN CANADA'S

ECONOMY WHILE ACKNOWLEDGING NEED FOR SOME MEASURES TO STIMULATE LAGGING GROWTH. TWO WEEKS AGO, WHEN TURNER TABLED REVISED BUDGET IN PARLIAMENT, HE WAS STILL PREDICTING REAL GNP GROWTH OF 4 PERCENT IN 1974; HOWEVER, HE DID PROPOSE TAX REDUCTIONS AND OTHER MEASURES TO REVERSE STEEP DOWNTURN IN HOUSING CONSTRUCTION.

8. HOUSING STARTS ARE DOWN BY 15 PERCENT DURING THE SECOND AND THIRD QUARTERS FROM THE PREVIOUS SIX MONTHS, AND WITH ACCELERATION IN DECLINE IN THIRD QUARTER, ADVERSE IMPACT IN HOUSING AND RELATED INDUSTRIES COULD BE EVEN STRONGER IN MONTHS AHEAD.

9. OTHER CONSTRUCTION MAY ALSO BEGIN TO BE CONTRACTED IF OIL COMPANIES AND OTHER MINERAL PRODUCERS CARRY OUT THEIR WARNINGS OF DECREASED INVESTMENT BECAUSE OF UNCERTAINTIES CREATED BY FEDERAL "PROVINCIAL CONFRONTATION ON RESOURCE TAXATION. OFFICIALS OF CANADIAN PETROLEUM ASSOCIATION TOLD PRESS ON NOVEMBER 29 THAT OIL INDUSTRY HAS REVISED SPENDING PLANTS DOWNWARD BY C\$1 BILLION (FROM A REPORTED \$2.1 BILLION) FOR 1975. (TACTICALLY, OF COURSE, IT APPEARS TO BE IN INDUSTRY'S INTEREST TO PLAY UP ACTUAL OR POTENTIAL CUTBACKS WITH VIEW OF INFLUENCING GOVERNMENTAL DECISIONS IN FAVORABLE DIRECTION.)

10. TRADE DEFICIT MAY ALSO WORSEN WITH PLANNED REDUCTIONS OF OIL EXPORTS TO U.S. IN 1975 AND WITH DOUBLE-DIGIT WAGE SETTLEMENTS INCREASING COST FACTOR FOR CANADIAN MANUFACTURED GOODS. NON-MERCHANDISE TRADE DEFICIT, WHICH WIDENED DURING THIRD QUARTER DUE TO DECLINING TOURIST AND TRAVEL RECEIPTS, COULD GET LIMITED OFFICIAL USE

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WORSE AS MORE U.S. CITIZENS ESCHEW CANADIAN TRAVEL DUE PREMIUM ON CANADIAN DOLLAR EXCHANGE AND HIGH COSTS OF GASOLINE.

11. CANADA'S ECONOMY DOES HAVE UNDERLYING STRENGTHS (OIL, OTHER MINERAL AND FOOD RESOURCES), WHICH HAVE PARTLY SHIELED IT FROM RECESSION THUS FAR. HOWEVER, LATEST FIGURES FROM STATCAN ARE NOT AT ALL REASSURING FOR THE MONTHS AHEAD. FURTHER DETERIORATION IN EXTERNAL TRADE, WORSENING HOUSING SLUMP, GROWING UNEMPLOYMENT AND POSSIBILITY OF DECREASED NON-RESIDENTIAL CONSTRUCTION HAVE OMINOUS IMPLICATIONS.

12. TURNER'S PROJECTED REAL INCREASE IN GNP OF 4 PERCENT FOR 1974 WILL BE ACHIEVED PROVIDED ECONOMY

DOES NOT ACTUALLY DECLINE IN FOURTH QUARTER. (STATCAN PUTS REAL GNP AT C\$76,168 FOR YEAR 1973; C\$78,168 FOR FOURTH QUARTER 1973; C\$79,292 FOR FIRST QUARTER 1974; C\$79,312 FOR SECOND QUARTER, AND C\$79,292 FOR THIRD. THUS, ALTHOUGH REAL GNP HAS ONLY INCREASED 1.4 PERCENT SINCE FOURTH QUARTER 1973, IT IS ALREADY RUNNING AT RATE ABOUT 4 PERCENT ABOVE FIGURE FOR 1973 AS A WHOLE.) FOR REASONS GIVEN ABOVE, THERE IS GOOD CHANCE CONFERENCE BOARD WILL PROVE TO HAVE BEEN RIGHT IN ITS REPORT OF SEPTEMBER WHICH PROJECTED SLIGHT DECREASE IN REAL GNP FOR FIRST QUARTER OF 1975.

13. TREND OF U.S. ECONOMY WILL BE KEY FACTOR. CANADA LUMBER INDUSTRY HAS BEEN PARTICULARLY HARD HIT BY U.S. HOUSING SLUMP AND AUTO INDUSTRY IS BEGINNING FEEL EFFECT OF DECREASED U.S. SALES. OTHER SECTORS OF CANADIAN ECONOMY WHICH DEPEND HEAVILY ON EXPORT SALES TO U.S. COULD EXPECT TO BE REVITALIZED IF U.S. ECONOMY TURNS UPWARD AGAIN. END LIMITED OFFICIAL USE. JOHNSON

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